DOCUMENT RESUME

ED 372 190 CE 066 720

AUTHOR Cappelli, Peter; Crocker-Hefter, Anne
TITLE Distinctive Human Resources Are the Core Competencies of Firms. EQW Working Papers WP18.
INSTITUTION National Center on the Educational Quality of the Workforce, Philadelphia, PA.
SPONS AGENCY Office of Educational Research and Improvement (ED), Washington, DC.
PUB DATE 93
CONTRACT R117Q00011-91
NOTE 24p.
PUB TYPE Reports - Research/Technical (143)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS *Business Administration; Case Studies; Competence; Competition; Corporate Education; *Diversity (Institutional); *Human Capital; *Human Resources; *Labor Force Development; On the Job Training; Organizational Development; *Personnel Management; Success

ABSTRACT

The interrelationship between people management practices and product market/competition was examined in a series of case comparisons of pairs of firms/organizations of the following types: professional sports teams, military services, retailing firms, information service firms, business schools, financial services, shipping services, and food and beverage companies. The case comparisons suggested a clear division between companies that develop employee competencies within the firm and those that assemble employee competencies ready-made from the outside market. Those firms that developed talent from within tended to rely more on group and organizational efforts to achieve competencies, whereas those firms that hired talent from without relied more on individual efforts. A clear division was also found between organizations that compete by moving quickly and adjusting to new opportunities and firms that have developed a superior approach to a long-standing market. Organizations of the first type did not develop employee talent from within because it did not pay for them to do so. The case comparisons were concluded to support the argument that there may be no such thing as "best practice" for all employers and that, like product differentiation, distinctive human resource practices help firms compete. (MN)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

EQW WORKING PAPERS

ED 372 190

Distinctive Human Resources *Are* the Core Competencies of Firms

by

Peter Cappelli

Co-Director

National Center on the Educational Quality of the Workforce

and

Anne Crocker-Hefter

The Center for Human Resources

The Wharton School

University of Pennsylvania

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

☒ This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

BEST COPY AVAILABLE

CF066720

"Distinctive Human Resources *Are* the Core Competencies of Firms"
EQW Catalog Number: WP18

The work reported herein was supported under the Educational Research and Development Center program, agreement number R117Q00011-91, CFDA 84.117Q as administered by the Office of Educational Research and Improvement, U.S. Department of Education. The findings and opinions expressed in this report do not reflect the position or policies of the Office of Educational Research and Improvement or the U.S. Department of Education.

Copyright © 1993 by the Trustees of the University of Pennsylvania

Contents

The "Best Practice" Bandwagon 1

People Management as the Core Competency 2

Employees Are the Product 3

Professional Sports: San Francisco '49ers and Los Angeles Raiders 3

Military Service: Israeli Armed Services and the French Foreign Legion 4

Sales as the Service 5

Retailing: Sears and Nordstrom 5

Information and Advice as the Product 7

Professional Service Firms: McKinsey & Company and Boston Consulting 7

Business Schools 9

Harvard Business School and The Wharton School 9

Financial Services 11

Insurance: Chubb and AIG 11

Going Beyond Service 13

The Shipping Business: Federal Express and United Parcel Service 13

Food and Beverages: Coca Cola and Pepsi 14

Conclusions 16

Policy Issues 17

Endnotes 19

The "Best Practice" Bandwagon

The popular literature in business has frequently offered up models of the best management techniques, especially for managing employees. The current interest in identifying "best practices" through benchmarking extends the argument that the best management practices are readily identifiable and can be transferred across organizations: find a firm with a reputation for excellence in some function, copy their practices, and you will have excellent service as well.

At the same time, however, explanations for what makes firms competitive are increasingly turning to the notion of "core competencies" that are unique to firms.[1] The search for unique competencies seems on its face to run counter to suggestions that firms should adopt similar practices or copy those of competitors.

Most of the interest in best practices and benchmarking is directed at management, especially managing people, but the notion of a single set of "best" practices in this area may at best be overstated. The first difficulty facing arguments that there is a single set of best practices is to explain why the variance in employment practices across firms continues to be so large. Surveys of employers indicate not only variance across firms but also that there are clear sets or combinations of practices that different firms pursue.[2]

Is the variance in employment practices simply an artifact? In the long run, competition drives out firms that do not adopt the most efficient techniques. When we see firms that have not adopted best-practice techniques, we are simply looking at those firms that will ultimately fail, or so the argument goes. As we illustrate below, however, there are examples in virtually every industry of highly successful firms that have very distinct management practices. We argue that these distinctive human resource practices help create unique competencies that differentiate products and services and, in turn, drive the competitiveness of the firms.

People Management as the Core Competency

We believe that in many areas of managing people, there may be no such thing as a "best practice" for all employers. Firms that are in competition with each other work hard to find ways to differentiate their products and to find niches in markets where they are protected from competition. Differentiating products is one of the essential functions of strategic management, and distinctive human resource practices help do that by shaping the core competencies that determine how firms compete.

The argument that there should be a "fit" between human resource practices and business strategies can be traced back to manpower planning and is certainly not new in management circles,[3] although it has been eclipsed by the volume of best-practice and benchmarking arguments. These arguments took business strategy as a given and then suggested how human resource practices could reinforce strategy. What is new here is the argument that people management practices are the beginning of efforts to create distinctive competencies and, in turn, business strategies.

The most obvious way through which employee-management practices create distinct competencies is through employee selection, providing access to employees with distinctive characteristics. Geographic location, for example, may create access to employees with different work ethics, preferences, and skills than competitors can achieve at the same labor costs. Different employment practices push the process of selection/self-selection along, aligning individual and organizational attributes (e.g., organizations that take risks attract employees who like risks). Having employees with distinct characteristics helps reinforce an organization's culture.

In addition to acquiring employees with distinct characteristics, competencies are also created by employment practices once new hires are in the firm. Practices in areas such as training, rewards, and work organization develop skills and behaviors that help an organization create distinctive competencies for attacking markets.

We illustrate these points by examining pairs of successful firms competing in the same industry. The paired firms have very distinct systems for managing people, and those differences shape the way they compete—and succeed—in their product markets.

Employees Are the Product

The link between people management practices and the way organizations compete is most direct in those organizations where employees create by themselves what the organization sells—where the product is a service provided directly by employees. Consider the following cases.

Professional Sports: San Francisco '49ers and Los Angeles Raiders

Professional sports are obviously big businesses in their own right and often serve as metaphors for organizations elsewhere. The rules governing sports restrict competitiveness to player performance (i.e., the equipment, playing fields, and time limits are standardized for all competitors), which makes it easier to see how "employee" performance matters.

The two football teams noted above have been among the most successful in American sports, yet they represent very distinct models of player management. The '49ers have succeeded using a strategy of long-term player development, recruiting through college drafts rather than through trades, developing talent within the team, and then keeping the best players by keeping them happy. Both facilities and salaries are among the best in the league. More so than other clubs, players on the '49ers have some influence on team decisions and feel a part of the organization.

On the field, the club relies on experienced players who act as team leaders and who have worked for years with their coaches. (The coaches and management staff also have long tenure with the team.) They have a reputation for playing as a precise, well-disciplined unit. Long-tenure players also help create long-term relationships with fans, helping cement their loyalty to the club. If production language could be applied to sports, this is a "high commitment" organization that operates as a "quasi-autonomous team" on the field. The approach has apparently paid off as the '49ers have won at least 10 games a year every year since 1983.

The Raiders, in contrast, do not as a rule develop their own players but use trades to scoop up talented players who fail or do not fit elsewhere. They have very high player turnover and a reputation as a club that functions as a collection of individuals who often do not fit together well, not as a "team" per se. As an organization, the Raiders are not known for treating players especially well, nor for letting them have much influence on team decisions. The team,

recently called "an organizational anomaly" (*Houston Chronicle*, Jan. 26, 1992), has an owner described as an autocrat who is personally involved in coaching and personnel decisions—no employee participation here. On the field, the Raiders are known for their individual performances and wide-open playing style, a style that makes good use of their pool of individual talent. Nor are the players known for their personal discipline, having "swashbuckled through Bourbon Street" during Super Bowl week, for example (but recovering by game day). Players have been characterized as everything from "weird and wired" to "flaky and sociopathic." But the Raiders have also had the best record in their conference over the past 10 years.

The practices of these two clubs create reputations that contribute to some self-selection of players, reinforcing their systems; those comfortable working in disciplined systems go to the '49ers while players who bridle at the constraints such systems impose go to the Raiders. It makes sense for the '49ers to staff their team with inexperienced players from the college draft in order to better "stamp" them with their own system; players from other pro teams are more likely to come in with expectations and playing habits that might be incompatible with the '49er system. Similarly, the fact that the Raiders hire experienced players who bring disparate attitudes and reputations that are not easily blended helps create their more individualistic playing style.

To some extent, football teams compete for fans the same way that firms compete for customers, and having distinct styles of play may help build a national audience. Having a distinctive and unusual style may also be useful in competition on the field, as well, in that it demands unusual responses from the other side that may be difficult to master.

Military Service: Israeli Armed Services and the French Foreign Legion

There are many other areas in which employees essentially are the service and employment practices vary widely, and one of the more unusual may be the military. Consider, for example, the difference between the Israeli armed services (where recruits are conscripted from the citizenry, where all recruits enter at the same level, and where the officer ranks are filled entirely by promotions) with the French Foreign Legion (where recruits are rarely citizens—often professional soldiers from other countries—and where officers and other specialized talent are hired from the outside).

Both services have reputations for effectiveness, and their different models make sense because they support different objectives. As a defense force, the Israeli army wants soldiers with close ties to the citizenry they are defending. Conscription and promotion from within serve those purposes, and the common experience of military service also helps bind the citizenry together. The French Foreign Legion, in contrast, operates as an expeditionary force always outside the country. Having a military force with few ties to the country insulates both the soldiers and the citizens from pressures that might otherwise be generated by operations that are unpopular with the domestic population—typically operations that are not in the direct defense of the country.

Sales as the Service

Retailing: Sears and Nordstrom

These two companies are both legends in the retailing industry. Sears was the world's largest retailer for generations and has outlasted all its historical competitors. During the 1980s, Nordstrom set service and growth standards for the industry. Although Sears stumbled in this period—as did most department stores—it has recently reorganized with expectations of improved performance. As with the other examples above, these two firms have very different employment practices, yet practices that make sense for their operations. The practices are compared for sales positions, the key job in retailing.

Sears has been and remains one of the pioneering firms in the science of employee selection. It relies on some of the most sophisticated selection tests in American industry to hire employees. Sears has refined these tests over time so that they now boast extremely high predictive power. Once hired, employees receive extensive training in company practices. Management also keeps track of employee attitudes and morale through frequent and rigorous employee surveys.

Two practices are especially noteworthy in the management of sales representatives. The first is intensive training in Sears products, the company's operating systems, and sales techniques. The second is that sales employees work entirely on salary—not commissions.

Nordstrom operates with virtually none of the formal personnel practices advanced by Sears. Indeed, its practices appear downright primitive in comparison. Nordstrom's hiring is decentralized, using no formal selection tests. Managers look for applicants with experience in customer contact (although prior retailing experience is often seen as a minus), but the main qualities seem to be pleasant personalities and motivation. The company has only one rule in its personnel handbook: "Use Your Best Judgement at All Times." Individual sales clerks virtually run their areas as private stores. Nordstrom maintains a continuous stream of programs to motivate employees and help them pursue the goal of providing intensive service, but it offers very little of what could be thought of as training. Its commission-based pay system makes it possible for sales clerks to earn sizable

incomes. Nordstrom sales personnel are also ranked within each department according to their monthly sales; the most successful are promoted (virtually all managers are promoted from within) and the least successful are let go.

In Nordstrom's fashion-oriented retail business, the service that customers demand is not detailed knowledge of the products. Rather, it is personal contact—emotional energy, in part—and hustle; running across the store to match an item, remembering an individual customer's tastes, etc. Impulse purchases are more important in fashion than in other segments of retailing, and the effort of the sales clerk can be especially helpful to such sales. What Nordstrom gets from its employment system is an intense level of personal motivation and customer contact. The commissions, internal competition, and motivation programs provide the drive while the absence of rules and autonomy allow it to be exercised. Many new hires do not survive—Nordstrom has among the highest turnover in the industry—but because the investment in each employee is relatively small (little selection or training costs), such turnover is not a real problem for the company.

Sears is also in the retail business, of course, and service is part of what it sells. But it is service of a different kind, in part because its product line is much more dominated by housewares than fashion. Customers buying home appliances or hardware want information about the products and how they are used. Sears also sells financing and warranties, reasonably complicated items which require some background knowledge. As evidenced by its marketing ("The Name You Can Trust"), Sears is trading in part on a reputation for steering the customer in the right direction. With this strategy, training is important, and turnover therefore is costly—hence, the emphasis on selection. Salary pay systems, as opposed to commissions, create no incentives to push products irrespective of customer needs or to cut back on the "non-selling time" associated with providing information.[4]

Information and Advice as the Product

Professional Service Firms: McKinsey & Company and Boston Consulting Group

McKinsey & Company and Boston Consulting Group (BCG) are among the world's leading strategic consulting firms. Both have world-wide operations, and their reputations for thoughtful leadership and quality service to management are comparable. Both firms hire from the best undergraduate and M.B.A. programs, competing for the top students. Both have rigorous selection procedures and exceptional compensation. Yet the characteristics of the people the two firms hire and the way they are managed once in their firms differ significantly in ways that relate to how each company approaches its markets.

BCG tends to attract candidates with very broad perspectives on business. Many have considered starting their own companies and sometimes have. BCG alumni often leave to start their own firms. BCG also maintains something of a "revolving door" with academia, hiring business school professors as consultants and sometimes losing consultants to faculty positions in business schools. Once hired, consultants jump right into research, albeit closely supervised, and the formal training they receive is likely to be outside courses.

BCG has an entrepreneurial environment, expecting each project team to come up with their own innovative approach. Each office is even thought to have a slightly different culture.

While BCG has some "products," such as time-based competition and capabilities-based strategies, these approaches are not the source of its competency. Indeed, some of them, like the "Growth-Share" matrix, were well-publicized and basically given away. The value-added comes from the customized application to the client's situation. Many of BCG's projects do not even start with these products but rather with a clean-sheet approach. What clients buy, therefore, are original solutions and approaches to their problems. And those approaches begin with consultants whose varied backgrounds and entrepreneurial spirit help produce a unique product.

McKinsey, on the other hand, historically has taken virtually all its new hires from on-campus recruiting and rarely from other employers. It has tended to prefer candidates with backgrounds in technical areas, such as

engineering and computer science, who have depth in some functional area of business. Their new entrants vary less in terms of their management experience and come in more as "blank slates" in terms of their consulting ideas. If McKinsey consultants leave, they are more likely to take senior line-management positions in corporations than entrepreneurial positions.

McKinsey provides new consultants with extensive training on the company's method of project execution and management, even though it is highly tailored to each client's situation. The firm expects the career path to the highest position, senior partner, to take approximately 12 years (versus 6 to 8 at BCG), which gives the consultants a long period to learn how to fit in.

In terms of its consulting product, the company is known for the "McKinsey way." McKinsey believes that it is important to provide their clients with consistent services; the client knows what to expect from the project teams. Their products and techniques are regarded as proprietary and are not publicized. Its core competency, therefore, is in the consistent products and techniques that constitute the "McKinsey way." To have consultants deliver that product in the same way across companies and countries, McKinsey takes bright people with strong skills and adapts them to that product.

Business Schools

Harvard Business School and The Wharton School

Not only is there a similar pattern across business schools in employment practices, but because these schools serve as supply channels for firms, there is also a relationship between the characteristics of business school employment practices and the firms that recruit at those schools.

As an employer, the Harvard Business School represents the end of the spectrum associated with internal development of skills. Harvard is well-known for identifying bright young academics who in many cases come from fields largely unrelated to business, hiring them as assistant professors, and turning them over time into business experts. Harvard is also known for faculty with unique skills and abilities, such as deep practical knowledge of business problems, typically acquired through clinical methods, and the ability to teach cases using the Socratic method. Compared to other schools, it is organized more by problem areas and teaching responsibilities than by academic fields.

Several personnel practices support the development of these skills. One is a system of postdoctoral fellowships specifically for Ph.D.s in non-business fields to help them learn about business. The best of these fellows are then hired as assistant professors. A second practice is a longer tenure clock than at many schools—nine years—which makes it easier for candidates to make the significant investment in Harvard-specific methods and for the institution to observe who is really fitting in. And the tenure evaluation is more likely to stress factors specific to Harvard, such as writing cases, and to rely on evaluations from internal faculty. Finally, Harvard has been much more inclined than most schools to hire their own students as faculty, providing a more direct way of ensuring that the faculty "fit" into the organization.

The Wharton School exemplifies the other end of the continuum. It seeks faculty whose work is recognized as excellent in academic fields such as finance, accounting, and management that exist independently from any individual school. In other words, it values skills and abilities that translate almost perfectly to competitors.

Like most business schools, Wharton hires its faculty from the network of Ph.D. programs and competitor schools with

similar departments that make up the academic labor market. It is extremely rare that the School will hire one of its own Ph.D. students. Indeed, a majority of the tenured professors will have been hired away from a faculty position elsewhere. The tenure decision is based largely on evaluations from faculty at other schools as a way of ensuring that successful candidates truly have skills recognized elsewhere. And the shorter tenure clock makes it easier to move faculty in and out, making use of the outside market.

What Wharton gets from its faculty, then, are skills oriented toward academic functional areas. Within the School, departments are organized according to academic fields. And the fact that it is the largest of the major business schools ensures that each department has considerable depth.

Given these different orientations, it is not surprising that the two schools produce different "products"—M.B.A. students with different strengths. Harvard graduates are known for a problem-oriented, general management approach and superior discussion skills, while Wharton graduates have much more of a functional orientation and superior analytic skills associated with functional areas. It makes sense, therefore, that companies interested in general talent like McKinsey prefer Harvard's M.B.A.s while those interested in specific skills, like investment banks, prefer Wharton graduates.

Financial Services

Insurance: Chubb and A.I.G.

The property and casualty section of the insurance industry is based, perhaps more directly than with other businesses, on knowledge and skills. The ability to identify and assess risk in unique situations, for example, is the central issue in this business, so it may not be a surprise that employees and the practices used to manage them are at the heart of competencies in this industry.

Yet we find a very wide range of people-management practices and policies in the property and casualty business, a range that once again appears due to different competitive strategies that are driven by different competencies. And the two property and casualty firms that are the most different with respect to people management are Chubb and A.I.G., among the most profitable firms in the entire insurance industry.

Chubb is often described by competitors as the "Cadillac" of its industry, successful by being the best at what it does. Chubb does not create new markets or drive the ones in which it participates through low prices. Instead, in the property business, it tries to find the very best risks that will provide a high return on its premiums. Chubb often goes after customers of other firms who it believes are good risks, identifies "gaps" or problems in their coverage, and offers them superior insurance protection. The core competency that makes these efforts possible is superior underwriting skills.

Among both businesses and individuals, Chubb also looks for customers that are willing to pay a premium for superior service that is manifested by intensive customer contact. It has a reputation for being the insurer of choice for the very wealthy who are willing to pay a premium for superior service and customer contact.

In short, Chubb earns above-market profits by targeting customers who will pay some premium for superior products and service and by identifying particularly good risks not spotted by competitors that will earn the company high profits. These competencies—superior underwriting and service—are generated by Chubb's employee-management practices.

Chubb makes a substantial investment in its employees, and that investment begins with recruiting. Historically, it has gone to the most prestigious undergraduate schools and hired graduates regardless of major (often from the liberal arts) who had good interpersonal and communication skills

upon which insurance-specific skills could be built. The recruiters seek out applicants who look like Chubb's customers, often coming from backgrounds that create contacts and make them comfortable with potential customers in the monied class.

New hires have several months of intensive training and testing before going to the branch into which they were hired. For the next 6 to 12 months, they work in an apprentice-like system in the field with established underwriters who provide a great deal of supervision.

With this substantial investment in skills, the company goes to great lengths through career planning to ensure that the new workers (and their skills) stay around long enough so that the investment can be recouped. First, they keep their underwriters from the boredom of desk jobs, which often produces turnover elsewhere, by making them the agents. The fact that underwriters go to the field to do the selling is a key factor in creating Chubb's competency. It eliminates the cost of agents and the communication problems between sales and underwriting, helps the underwriter get better information for assessing risks, and also provides customers with better service, especially better information about risks. The superior abilities of the underwriter/agents makes it possible to combine these two roles.

Second, Chubb fills vacancies internally, moving people frequently and retraining them for new jobs. The pace of work eventually pushes some people out of the organization, but they rarely go to other insurance companies and more typically become independent agents, helping to expand the network for Chubb's business. And this turnover expands what would otherwise be very limited opportunities for career development in a reasonably stable organization.

A.I.G. achieves its high level of profitability in a different way, but one that also relies on its human resources. A.I.G. is a market maker. It identifies new areas of business, creates new products, and benefits from "first mover" advantages in getting to those markets. A.I.G. thrives in markets where it has little competition. Once companies that compete on price enter those markets, A.I.G. might well move on to another product.

The company's competencies, therefore, are in marketing—identifying new business areas—and in the ability to change quickly. It pursues the latter with a set of policies that are virtually the mirror opposite of Chubb's. It operates in a highly decentralized manner by creating literally hundreds of subsidiary companies, each targeted to a specific market. It creates new companies to attack new markets and staffs them by hiring experts with industry skills from other firms. Given that the "core competency" is variation, A.I.G. has little interest in developing commonalities across its companies, and therefore no need to manage them tightly from the center. The executives in each company are managed through a series of financial targets—with generous rewards for meeting them—and are otherwise given considerable autonomy in running the businesses.

When a market dries up or tough competition arrives, a company in that market may close down and the employees will be let go to return to the industry's labor market. The fact that the company changes markets so quickly would make it difficult to recoup the investment it would need to develop new market-specific skills itself, so it relies on the outside labor market instead.

The advantages of speed in attacking markets effectively make other ways of competing difficult. For example, hiring experienced employees away from competitors without offering any real job security means that A.I.G. is paying top dollar to get them, expenses that would make it difficult to compete on the basis of cost and price. A similar argument could be made about Chubb: that the investment in people required to develop the competencies needed to exploit existing markets would be too slow and expensive for attacking new markets as they emerge.[5]

Going Beyond Service

The link between employees and product market strategy is sometimes less direct when one moves away from services because many factors in addition to employee behavior affect the company's "product." But there are still relationships among the way employees are managed, the competencies employees help produce, and the way companies compete. Consider the following examples.

The Shipping Business: Federal Express and United Parcel Service

It is difficult to find two companies with people-management systems that are more different than those at FedEx and UPS. FedEx has no union, and its workforce is managed using most of the hot items in contemporary human resource management. For example, individual and group performance are assessed, and both influence pay. The company has pay-for-suggestion systems, quality-of-worklife programs, and a variety of other arrangements to "empower" employees and increase their involvement. Employees at FedEx have had an important role in helping to design the work organization and the way technology has been used. And they have a workforce whose hustle It is difficult to find two companies with people-management systems that are more different than those at FedEx and UPS.

UPS, on the other hand, has none of these people-management practices. Employees have no direct say over work organization matters. Their jobs are designed by industrial engineers according to time-and-motion studies. The performance of each employee is measured and evaluated against company standards for each task, and they receive daily feedback on their performance. There are no efforts at employee involvement other than collective bargaining over contract terms through the Teamsters' Union, which represents drivers. The union at UPS does not appear to be the force maintaining this system of work organization. The initiative on work organization issues has been with management, which has shown little interest in moving toward work systems such as the kind at FedEx.

The material rewards for working at UPS are substantialand may more than offset the low level of job enrichment and the tight supervision in the minds of employees. The company pays the highest wages and benefits in the industry. It also offers employees gainsharing and stock ownership plans. UPS remains a privately held company

owned by its employees. In contrast to FedEx, virtually all promotion (98 percent) at UPS is filled from within, offering entry-level drivers excellent long-term prospects for advancement. As a result of these material rewards, UPS employees are also highly motivated and loyal to the company. The productivity of UPS's drivers, the most important work group in the delivery business, is about three times higher (measured by deliveries and packages) than those at FedEx.

Why might it make sense for UPS to rely on highly engineered systems that are generally thought to contribute to poor morale and motivation and then offset the negative effects with strong material rewards, especially when FedEx offers an alternative model with high levels of morale and motivation and lower material rewards? Differences in technology do not explain it. FedEx is known for its pioneering investments in information systems, but UPS has recently responded with its own wave of computerized operations. Yet the basic organization of work at UPS has not changed.

The employment systems in these two companies are driven by their business strategies. FedEx is much the smaller of the two companies, operating until recently with only one hub in Memphis, and focusing on the overnight package delivery service as its platform product. UPS, in contrast, has a much wider range of products. While its overnight delivery volume is only 60 percent of Federal Express's, its total business is nine times as large (11.5 million deliveries per day at UPS versus 1.2 million at FedEx).

The scale and scope of UPS's business demands an extremely high level of coordination across its network of delivery hubs, coordination that may only be achievable through highly regimented and standardized job design. The procedures must be very similar, if not identical, across operations if the different delivery products are to move smoothly across a common network that links dozens of hubs. Changes in practices and procedures essentially have to be system-wide to be effective. Such coordination is incompatible with significant levels of autonomy of the kind associated with shop-floor employee decision making. It is compatible with the system-wide process of collective bargaining, however.[6]

In short, the scale and scope of UPS's business demands a level of coordination that is incompatible with individual employee involvement and a "high commitment" approach. UPS substitutes a system of unusually strong material rewards and performance measurement to provide alternative sources of motivation and commitment. Having historically one hub at FedEx meant that there were fewer coordination problems, allowing considerable scope for autonomy and participation in shaping work decisions at the work group level and more of a "high commitment" approach.

Food and Beverages: Coca-Cola and Pepsi

Few products appear to be more similar than soft drinks, yet the "Cola Wars" that mark the product-market competition between these two companies show how even organizations with highly similar products can be differentiated by their business strategies.

Coke is the most recognized trademark in the world. First marketed some 70 years before Pepsi, Coke literally has been a part of American history and culture. In World War I, for example, Coca Cola bottling plants went to Europe along with the U.S. forces. With such enormous recognition in the market, Coke's business strategy centers on maintaining its position and building on its carefully groomed image. Compared to other companies its size, Coca Cola owns and operates few ventures besides Coke (especially now that its brief fling with Columbia Pictures is over) and has relatively few bottling franchises with which to deal. Indeed, the largest franchisee, which controls 45 percent of the U.S. market, is owned by Coca Cola itself.

Given its dominance, the Coke trademark is something akin to a proprietary technology, and Coca Cola's business strategy turns on subtle marketing decisions that build on the

trademark's reputation. This is not to suggest that running Coke's business strategy is easy. Rather, the decisions are highly constrained within a framework of past practices and reputation. (One of the reasons that "New Coke" was such a debacle, it can be argued, was that it broke away from the framework represented by Coke's tradition.)

Managing Coca Cola therefore requires a deep, firm-specific understanding and feel for the trademark that cannot be acquired outside the company or even quickly inside it. What Coke does, then, is use an employment system that both creates those skills and hangs onto them. Coke typically hires college graduates—often liberal arts majors and rarely M.B.A.s—with little or no corporate experience and provides them with intensive training. Jobs at Coke have been very secure, virtual lifetime employment for adequate performers, and a system of promotion-from-within and seniority-based salary increases provides the carrot that keeps employees from leaving. The internal company culture is often described as family-like with a high degree of employee loyalty to Coke. Decision making is very centralized. There is little autonomy and a low tolerance for individual self-aggrandizement: no one wants an unsupervised, low-level decision backfiring on the trademark. To reinforce the centralized model, performance is evaluated at the company or division level.

Beginning with the blank slate of college graduates, Coca Cola slowly steeps its employees in its culture, in this case, an understanding of the trademark's image. The people-management system then ensures that only career Coke managers who have been thoroughly socialized into worrying about the company as a whole get to make decisions affecting the company.

Perhaps the main point in understanding Pepsi is simply that it is not Coke. Pepsi has prospered by seeking out the market niches where Coke is not dominant and then differentiating itself from Coke. From its early position as a price leader ("Twice as Much for a Nickel") to contemporary efforts at finding a "New Generation" of consumers, Pepsi cleans up around the wake left by the Coke trademark.

One way Pepsi has found new markets is to become highly diversified. Its fast-food operations—Taco Bell, Pizza Hut, Kentucky Fried Chicken—provide proprietary outlets for Pepsi soft drinks. Pepsi markets more aggressively to institutional buyers like hotels and restaurants than does Coke, which is focused on individual consumers. Pepsi also has many more bottling franchises that operate with some autonomy.

Given this strategy of operating in many different markets, Pepsi faces a much more diversified and complicated set of management challenges. It needs more innovative ideas to identify market niches, and it needs the ability to move fast. Its people-management system makes this possible. Pepsi hires employees with experience and advanced degrees, high-performing people who bring ideas with them. In particular, Pepsi brings in more advanced technical skills. Once in the company, Pepsi fosters individual competition and a fast-track approach for those who are successful in that competition. The company operates in a much more decentralized fashion, with each division given considerable autonomy, and performance is evaluated at the operating and individual levels.

Pepsi employees have relatively little job security, a point that is accentuated by the absence of a strong promotion-from-within policy. In part because of higher turnover, Pepsi employees have significantly less loyalty to the company than do their counterparts at Coke. Indeed, the main issue that unites them, some say, is their desire to "beat Coke."

What Pepsi gets from this system is a continuous flow of new ideas (e.g., from experienced new hires), the ability to change quickly (e.g., hiring and firing), and the means for attacking many different markets in different ways (e.g., decentralized decision making with individual autonomy).

Conclusions

The pattern of practices described above suggests a clear division between companies that develop employee competencies within the firm (Chubb, Coke, the '49ers, McKinsey) and those that assemble them ready-made from the outside market (A.I.G., Pepsi, the Raiders, BCG). The firms that develop talent from within also tend to rely more on group and organizational efforts to achieve competencies, while the firms that hire it from the outside rely more on individualism and individual efforts. This relationship seems intuitive. The skills and behaviors needed for individual-based performance are readily available on the outside market because they can be produced and used in many settings. The skills that generate organization-based performance, in contrast, are likely to be specific to that organization and therefore are unlikely to be produced anywhere else. Developing employees from within also creates and passes on the kind of strong culture that reinforces group and organization performance.

The difference in autonomy illustrated by the UPS/FedEx example can also be related to the inside/outside dimension. The coordination that reduces the scope for autonomy in companies such as UPS is, in itself, an organization-level competency. Such competencies, in turn, demand that employees be developed within the organization, illustrated at UPS by the extensive training employees receive in performing its precise job designs and by its near-universal promotion-from-within program. A similar explanation accounts for the autonomy that Nordstrom's sales force has, the individualism through which performance is manifested there, and the reliance on skills that new hires bring with them as compared to Sears.

Companies that secure skills and competencies in the outside market obviously face a dilemma: If these competencies are in fact available to everyone on the open market, how can they generate a unique competency and competitive advantage for any one firm? One answer is that a firm may be better at spotting talent on the open market or at managing that talent than their competitors, who are also trying to secure skills and competencies directly from the market. The Raiders' player management, for example, is particularly good at incorporating and accommodating talented players who have trouble playing effectively under other systems. The fact that BCG is able to hire new consultants at salaries

somewhat below those of its leading competitors suggests a competency in recruiting—an ability to identify underpriced talent and/or job characteristics that substitute for salary. Similarly, Nordstrom's system of incentives, employee autonomy, and motivation programs gets more out of the general abilities of its sales staff than competitor systems and, according to Nordstrom executives, has proven difficult to translate to competitors. In other words, the competency is in selecting and managing talent, rather than developing it.

Another important theme appears in the product market. There is a clear division between organizations that compete by moving quickly, adjusting to new opportunities, and firms that have developed a superior approach to a long-standing market. And the two themes relate to each other in an extremely straight-forward manner: organizations that compete through flexibility, moving quickly to seize new opportunities, do not develop employee competencies from within because it does not pay to do so. The opportunity is likely to be gone before the investment to develop competencies for addressing the opportunity can be recouped. Instead, these organizations rely on the outside market to take in new competencies, individualism to sustain performance, and the outside market to get rid of old competencies. Organizations that compete through established markets and relationships, on the other hand, rely on organization-specific skills developed internally and group-wide coordination.

There may well be a natural equilibrium in the marketplace between these two kinds of firms. Companies like Pepsi and A.I.G. exist in part because they have competitors like Coke and Chubb who do not, perhaps cannot, adapt quickly to new opportunities; similarly, companies like McKinsey and Goldman succeed because their competitors lack the depth of competencies and long-term investments that they have established.

One factor that helps sustain this equilibrium is the difficulty in changing strategies. Historical investments in a particular approach create considerable inertia and reputations that, in turn, affect employee selection long after those investments have been exhausted. Going from an "inside" employment strategy to a market or "outside" approach can probably be done more easily than the reverse. It involves discarding the firm-specific assets and going to the market for new ones. General Electric under Jack Welch may represent one of the more successful attempts to make such a change in strategy, and even there it has taken about a decade and generated considerable conflict. IBM appears to be heading in that direction as well, especially with its efforts to spin-off human resource functions to a vendor, Employment Solutions. It is very difficult, however, to find examples of mature firms that have gone from a market approach to an inside employment strategy.[7]

The increase in the need for flexibility driven by competition that most all firms feel may be exacting a toll on employers who develop their own competencies. Even companies like Coca Cola and McKinsey are beginning to take in more talent from the outside, and schools like Wharton that traditionally supplied functional skills are changing curricula to ensure that their graduates are broader and more flexible. Some important part of the recent decline of IBM is attributed to their inability to respond to changing markets, a lack of flexibility that may well have been related to their reluctance to take in talent and new ideas from the outside. In the future, all firms may reduce the extent to which they develop competencies inside, although the variance in these practices across firms may still be great.

Policy Issues

Several policy implications flow from these observations. One set concerns training. First, in most industries, there are markets for organizations that move quickly, too quickly to merit making substantial investments in training and development.

It is difficult to imagine any sensible public policy that could encourage these organizations to develop their talent themselves. Efforts to do so would change their core competencies and push them out of their current market niches.

Second, to the extent to which some of the job skills of the new hires who go to these fast-mover firms were paid for by the developing firms, a substantial subsidy is moving from the latter to the former. There might well be an argument for tax incentives as part of any training policy that would help offset this cross-subsidy.

Similar conclusions apply to issues of work organization. The scope for autonomy/worker participation, teamwork, and related issues that are sometimes labeled as "high performance" work systems is at least in part driven by the choice of product market strategy. The extent to which individualism drives performance or coordination in turn shapes the scope for work organization. Efforts to change these dimensions will also change core competencies and business strategies.

Incentives for organizations to adopt practices are likely to be unsuccessful given these effects, and mandates that force organizations to adopt employment practices that change their capabilities may have unanticipated effects on the way they compete. Some might argue that changing business strategies is a desirable outcome. In European countries, the constraints on dismissing employees/using the external labor market encourage investments in existing employees and, it is argued, shift production toward the higher-quality (and higher-cost) markets that make use of higher skills.

If, in fact, the need for flexibility in product markets continues to increase, the extent to which firms will explicitly invest in specific skills and competencies may erode. It is an important empirical question as to whether firms with highly skilled, broadly trained employees can be more flexible in their product markets than can firms that hire-and-fire to change their competencies. The former may well be better at creating flexibility within one's current product market (e.g., "quick response" or customized production) although the latter may achieve more flexibility in moving across product markets (e.g., abandoning one market and moving to another). Certainly firms in the U.S. appear to have moved decisively toward the latter. There is no doubt this will reduce the extent to which distinctive competencies are created within firms. Whether this change will make the high-competence, specific-skill niches of firms like Chubb too short-lived to be profitable or whether firms will find lower-cost ways of creating the necessary competencies, possibly assembling them from the outside market, is an open question.

The fact that distinctive ways of competing appear to be driven by competencies and capabilities that are created by unique sets of employee management practices helps explain several interesting observations about the business world. The first, noted above, is the substantial variance in management practices across employers which persists despite the considerable pressures to adopt practices that appear successful and "legitimate" elsewhere. The second related observation is that many practices that have been demonstrated to be "best" in some firms never seem to sweep over the business community as a whole, even after being promoted for years.[8] Both observations are perfectly compatible with the notion that differences in business strategies are functional and are generated by differences in management practices.

None of this suggests, of course, that all practices are equally good. For practices that are not central to an organization's core competency, there may indeed be best practices that clearly cut across firms; for companies with similar business strategies, hence similar core competencies, it may also be possible to identify management practices that dominate other—"lean production" among auto assemblers, for example.

To be a source of sustained competitive advantage, an asset or practice must be something that does not easily transfer to competitors. One factor that makes people-management practices a source of distinctive capabilities is that, unlike technology or new designs, these practices can be extremely difficult to reproduce elsewhere, as research on organizational change makes clear. Indeed, the fact that these practices are so difficult to change and transfer helps explain the basic notion that core competencies should drive business strategy and not vice versa. It may be easier to find a new business strategy to go with one's existing practices and competencies than to develop new practices and competencies to go with a new strategy.

Endnotes

[1] See C.K. Prahalad and G. Hamel. "The Core Competence of the Corporation." *Harvard Business Review*, May-June 1990, pp. 79-91.

[2] See, for example, Edward E. Lawler III, Susan Mohrman, and Gerald E. Ledgord, Jr., *Employee Involvement and TQM: Practice and Results in Fortune 5000 Companies* (San Francisco: Jossey-Bass, 1992). Several studies find patterns of different practices within the same industries. See Jeffrey B. Arthur, "The Link Between Business Strategy and Industrial Relations Systems in American Steel Minimills," *Industrial and Labor Relations Review*, vol. 45, no. 3, 1992, pp. 488-505, for one such example. "America's Choice: High Skills or Low Wages!" (Rochester: National Center on Education and the Economy, 1990) produced the 5-percent estimate of employers that had adopted high-performance work systems.

[3] Morse and Lorsch argued, for example, that the best structure for an organization depends on the nature of the work being done ("Beyond Theory Y," HBR May/June 1970, p. 61), and Robert A. Luke extended the argument to consider the fit between the task requirements of employees, their competence needs, and the organizational structure ("Matching the Individual and the Organization," HBR, May/June 1975, p. 28).

[4] Interestingly, Sears' recent problem with fraud in its automotive business provides an exception that proves the rule: automotive managers operated on commissions and quotas that provided incentives to push repairs, in many cases apparently where they were not needed.

[5] Goldman-Sachs and Salomon Brothers provide a similar dichotomy in investment banking that is driven by the employee-ownership structure. The partnership model at Goldman ties its executives to the firm over the long haul by giving them a stake in the company, and long tenure helps cement long-standing ties to clients. The executives at Salomon, in contrast, are employees with less attachment to the firm, who may come and go with their own set of contacts and clients. Salomon's executives are motivated by generous financial incentives. As a result, Goldman's business concentrates on long-term customers and major deals with them; Salomon's business is driven by a larger number of clients, a wider range of opportunities, and more short-run deals. By incorporating, Salomon is also able to raise capital through the stock market which enables it to pursue different business opportunities. We are indebted to Peter Sherer for these insights.

[6] The highly integrated system at UPS parallels the experience with assembly line production, where workers are closely coupled to each other by the line. The elimination of "buffers" or inventory stocks between work stations associated with just-in-time systems increases the coupling and dictates that the pace at which work flows be the same across all groups, substantially eliminating the scope for autonomy within groups and increasing the need for coordination across groups. The delivery business is like an extreme version of a just-in-time system in that there can be no buffers; a package arrives late from another hub, and it misses its scheduled delivery, clearly a worse outcome even than a temporary break in the flow of an assembly line. And the more points of interchange, the more the need for coordination.

[7] Start-up firms and those that are growing rapidly have no choice but to rely on a market approach to get staff, and some of these firms eventually switch to an inside strategy. But that is not the same as the transition from outside to inside for mature firms.

[8] This is perhaps most easily documented in the area of employee participation in work decisions, where best-practice arguments encouraging an expanded role for employees are now more than 50 years old. See Thomas Bailey, "Discretionary Effort and the Organization of Work: Employee Participation and Work Reform since Hawthorne" (New York: Sloan Foundation, 1992), for a discussion.

BEST COPY AVAILABLE

National Center on
the Educational Quality
of the Workforce

University of Pennsylvania
4200 Pine Street, 5A
Philadelphia, PA 19104-4090